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SUBJECT: U.S.-EU STRATEGIC ENERGY REVIEW

¶1. SUMMARY: On March 3, EU Energy Commissioner Andris Piebalgs and Under Secretary Reuben Jeffery co-chaired the second annual U.S.-EU Strategic Energy Review, established at the June 2006 U.S.-EU Summit to review progress in U.S.-EU energy cooperation. Discussions covered cooperation on energy technologies aimed at lessening dependence on imported hydrocarbons and the geopolitical aspects of energy security, including diversification of hydrocarbon sources and suppliers. The two sides: (1) briefed each other on recent energy policy developments; (2) agreed to continue to increase cooperation on energy technologies, and in particular on sustainability standards for biofuels; (3) exchanged views on enhanced International Energy Agency engagement with China and India; and (4) reviewed key Eurasian gas diversification proposals and projects. END SUMMARY.

¶2. U.S. participants in the meeting included NSC Senior Director for European Affairs Damon Wilson; EEB A/S Sullivan; Special Envoy for European Union Affairs Boyden Gray; Department of Energy DAS Carmen Difiligio; NSC Director for European Union Relations and European Economic Affairs Lauren Catipon; USEU Economic Counselor Peter Chase; EUR/ERA Director William Lucas; and EEB/ESC/IEC Director Steve Gallogly. EU participants included Roland Kobia, Member of Piebalgs' Cabinet; Ferran Tarradellas Espuny, Spokesperson for Energy; Laurent Muschel, Head of Unit, International Relations, Directorate General for Energy and Transport; Ulrich Eckle, Policy Officer, DG RELEX; and Mr. Igor Salamun, Director General, Directorate for Energy, Ministry of the Economy.

Piebalgs: EU Starting to Pull Together on Energy Policy

¶3. Commissioner Piebalgs spoke with enthusiasm about the growing role of the European Commission in formulating European energy policy and the increasing coordination among member states. While energy policy has been a member-state competency, with the Commission relying on its prerogatives in competition policy, environment, and consumer protection to influence it, Piebalgs said that the Lisbon Treaty would give the Commission greater control in energy policy. He saw progress in three areas: (1) development of an integrated internal energy market; (2) promotion of cleaner energy, renewable energy, and energy efficiency to reduce greenhouse gas emissions; and (3) greater unity on external energy relations and

the need to diversify energy sources. On internal market integration, Piebalgs noted the Commission's September 2007 package, which, if adopted, would institute improvements in EU-wide regulatory cooperation and the implementation of corporate asset unbundling and competition rules for all gas and power companies operating in the EU. Piebalgs indicated that he aims for a member-state political agreement on the package by June, and adoption by co-decision with the European Parliament before the end of 2008.

14. Turning to the Commission's January 2008 climate change and energy package, Piebalgs asserted that its "20-20 by 2020" binding targets on individual member state emissions and renewables use - including in the transportation sector - as well as its efficiency requirements for all appliances, would be critical to providing a guaranteed framework and stability to encourage investment in alternative energies. Piebalgs also noted progress on diversification of energy sources and coordination of external energy policy, including establishment of an agency or institute to examine energy issues and forecast global energy supply and demand. Piebalgs argued that European demand projections may provide a rationale for moving forward simultaneously with multiple new pipeline projects, for example, development simultaneously of Nabucco with Russia's new South Stream proposal that would reach the same geographic sub-market.

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Difiglio: EISA Promotes Commercialization of Cleaner, More Efficient Energy

15. Department of Energy DAS Carmen Difiglio briefed the EC delegation on: (1) the Energy Independence and Security Act of 2007 (EISA) - signed into law in December 2007 - explaining the difference between Congressional appropriations and authorizations; and (2) the restructuring of the Department of Energy's FutureGen program. Difiglio indicated that the most significant provision in EISA is the mandate to increase the national fuel economy standard to 35 miles per gallon by 2020 - which will increase fuel economy by 40% and save billions of gallons of fuel; this requirement represents the first statutory increase in automobile fuel economy standards since 1975. EISA also requires fuel producers to use at least 36 billion gallons of renewable fuels by 2022 (a nearly five-fold increase over previous requirements), which combined with restrictions on the types of land used for biofuel production, will encourage a shift from first-generation biofuels to second-generation cellulosic-based biofuels. EISA also calls for a 30% increased energy efficiency of light bulbs, which will effectively lead to a phase-out of most incandescent light bulbs by 2012.

16. DAS Difiglio also explained that EISA - and President Bush's FY09 budget requests - significantly increase the potential resources available for carbon capture and storage (CCS) development and authorize seven large-scale CCS projects. Difiglio noted that the recent restructuring of FutureGen was a change in the right direction, as it will push CCS technology out of the publicly-funded research institutes and non-governmental organizations and into the realm of commercial development. The restructured FutureGen should nicely complement the EC proposal to fund as many as a dozen CCS systems in EU Member States. Commissioner Piebalgs indicated that the EC is working on enabling legislation for CCS projects to address issues such as liability and will consider 100% state aid, on a project-by-project basis.

¶7. Reviewing the four principal areas of energy technology cooperation, Commissioner Piebalgs considered U.S.-EU work on biofuels to have been the most successful, with only limited results having been achieved in our collaboration on CCS, energy efficiency, and energy research and development. He noted a strong public concern - fanned by arguments from the oil industry - on sustainability of biofuels, particularly their impact on food prices, water, and land use. Biofuel sustainability standards proposed by the EC, developed in close consultation with industry, mandate that biofuels contribute to a minimum of 35% reduction in CO2 and prohibit the use of wetlands and other areas of biodiversity for cultivation of biofuel crops. Arguing that the U.S. and the EU need to develop a united approach on biofuel sustainability criteria, Piebalgs pressed for regulatory and technical cooperation to develop the next generation of biofuels. He highlighted the need to address in future discussions the problem of distortions caused by biofuel subsidies, and asserted that the U.S. system of subsidizing production causes more market distortion than the EU system of subsidizing consumption. The result, he said, is that U.S. exports of biofuels to the EU market enjoy a double subsidy, while European producers are disadvantaged.

¶8. U/S Jeffery acknowledged the importance of cooperation on biofuels - including trilateral efforts with Brazil - to develop standards on sustainability. Special Envoy C. Boyden Gray observed that the challenges are both technical and public in nature, noting Brazil is nervous that biofuels are developing a negative image in the U.S., EU, and elsewhere. Gray elaborated that the main source of the publicity challenge in Europe is public concern over genetically modified organisms, sustainable use of resources, and biodiversity impacts,

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whereas the main source of contention in the U.S. is the energy industry's aversion to competition and OPEC opposition. He commented with irony that some wealthy OPEC countries, by virtue of their membership in the G-77 group of developing nations, are demanding compensation for the corresponding decrease in oil use due to fuel substitution linked to climate change concerns.

¶9. SE Gray suggested using the Transatlantic Economic Council to promote U.S.-EU cooperation on sustainability standards, while using the G8 process to address the biofuels public relations challenge. A/S Sullivan, the G8 Sous Sherpa for the U.S., agreed that the G8 could be an appropriate venue for a statement underscoring the importance of biofuels to nations' energy security strategies. Piebalgs suggested issuing a joint statement on sustainability through U.S.-EU dialogue.

¶10. Finally, SE Gray noted that U.S. legislation will require a cap of CO2 emissions in preparation of land for biofuels cultivation, i.e. - a limit on the amount of CO2 released per acre in order to make the land "biofuels ready." Gray cautioned that the EU should work with the U.S. on this issue or risk being "trumped" by U.S. regulation taking the lead.

IEA Outreach: Eventual Membership for China, India and Russia

¶11. (SBU) Moving to questions of International Energy Agency outreach and enlargement, Commissioner Piebalgs noted that the EC does not have a set position on eventually extending IEA membership to China, India

and Russia, but cautioned against any moves that would dilute the IEA's effectiveness by bringing in members that didn't share the organization's values. U/S Jeffery noted that the U.S. is supportive of enhanced IEA engagement - and possibly expansion - while agreeing that it is not in U.S. or EU interests to dilute the IEA's efficacy. However, U/S Jeffery told Piebalgs that U.S. policy on this issue is evolving and we should continue our dialogue on IEA expansion.

¶12. (SBU) A/S Sullivan argued that since the IEA is dedicated to energy-consuming countries, IEA member states' interests converge in many areas with those of China and India. He stressed the importance of bringing China into a transparent market system and up to IEA standards, which would strengthen, not dilute, the IEA. Sullivan also noted that China and India participated in the IEA's Committee Week in December 2007, and that IEA engagement and expansion would be discussed at the upcoming March 12-13 Governing Board meeting. He advocated beginning discussions with the two countries now, considering that the process will take a number of years, even in a best-case scenario. Russia, in contrast, has not indicated the same level of interest in IEA engagement, Sullivan noted, perhaps because it sees its interests more in line with those of other energy-producing countries. Ulrich Eckle of the EU's Directorate General for External Relations asked if this is an issue the G8 could address, to which A/S Sullivan responded that the G8 is waiting for the outcome of the IEA Governing Board meeting before taking action.

Diversity of Supply and External Strategies

¶13. (SBU) U/S Jeffery invited Commissioner Piebalgs to provide views on competing natural gas pipelines, the economic and political benefits of each, and how best to engage as governments to increase available supplies. U/S Jeffery added that the EU could not ignore engagement with Russia on energy issues. Piebalgs responded with a comprehensive discussion of upstream potential, Ukraine, and an overview of competing gas infrastructure projects.

¶14. (SBU) On Central Asia, Piebalgs spoke of the need to go slow with Turkmenistan and not let negative incidents feed Turkmen fears that foreigners want to rob them of their natural resources, referring to a recent commercial development involving a European company. He foresaw no

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gas from Kazakhstan available for the EU in the near term but possibly some from Uzbekistan. Piebalgs alluded to tensions between the EC and Algerian natural gas company Sonatrec related to the Commission's unbundling proposals, and expressed strong interest in importing gas from the Akkas field in Iraq's Anbar province into Europe. Piebalgs expressed little sympathy for Ukraine, arguing that its system of middlemen makes no sense. In the ongoing negotiations between Ukraine and Gazprom, Piebalgs found the Russians more transparent with him than the Ukrainians. He considered the underlying problem to be the continuing political rivalry between Tymoshenko and Yushchenko, which feeds corruption in Ukraine.

¶15. (SBU) Piebalgs said the Commission's prime interest is diversification of energy supplies, and that Nabucco is the Commission's priority project for bringing Caspian and Middle Eastern gas to Europe. He added that after Nabucco, other proposed pipelines would be welcome if they bring new sources of gas to the EU. Piebalgs outlined the Commission's current thinking on a variety of gas infrastructure projects:

-- Nord Stream: The Commission would not actively

discourage Member States from advocating an alternative land-based routing of the pipeline that is more palatable to the Baltic States and Poland, nevertheless Piebalgs predicted that Nord Stream will be built as currently projected, adding that the EC's role is to encourage transparency on the part of the partners.

-- South Stream: Piebalgs said flat out that he initially thought South Stream was a political ploy and never expected it to be built due to the costs and questionable project rationale. He questioned spending billions of dollars to put a pipeline under the Black Sea, but answered himself by noting that South Stream's purpose is to bypass Ukraine. However, in light of recent developments in the Balkans and Black Sea region, he is not ruling the pipeline out; and the Commission's position on South Stream is neutral, neither encouraging nor discouraging South Stream's construction.

-- Nabucco: The proposed Nabucco pipeline is the EC's top priority for diversification of natural gas supplies. The challenge is securing the natural gas supplies from Azerbaijan, Iraq, Egypt, and other sources. Piebalgs indicated that Turkey is a problem due to the disagreement over transit arrangements with upstream producer Azerbaijan. While Piebalgs said that in reality it does not matter who contracts with the EU to supply the gas - Azerbaijan or Turkey - the disagreement between the two is an impediment, so Turkey needs to come to a fair agreement with Azerbaijan.

-- White Stream: Despite the fact that the European Commission is considering funding a feasibility study on the White Stream pipeline, Commissioner Piebalgs does not support the project, as it is designed to bypass Turkey; he indicated that the EC is not in the "bypassing business" and prefers to deal with Turkey, encouraging it to become a responsible transit country.

-- Turkey-Greece-Italy (TGI): Despite the fact that the Greece-Italy portion of the pipeline has not been built and there are no substantial gas sales and purchase agreements for the pipeline, Piebalgs indicated that he sees this project as complete, requiring no Commission action.

-- Trans-Adriatic Pipeline (TAP): Piebalgs sees this proposed pipeline as a competitor for TGI, and so is not supportive at this time.

-- Trans-Caspian Pipeline (TCP): The EC supports an eventual trans-Caspian pipeline to transport Turkmen gas westward but, similarly to the current U.S. view, favors connecting Turkmen offshore fields as a first step/proof of concept.

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